Serial No. 2008/94

IN THE HIGH COURT OF JUSTICE OF THE ISLE OF MAN
CHANCERY DIVISION

IN THE MATTER OF THE COMPANIES ACT 1931

AND IN THE MATTER OF KAUPTHING SINGER & FRIEDLANDER (ISLE OF MAN) LIMITED

AND IN THE MATTER OF THE JOINT PETITION OF KAUPTHING SINGER & FRIEDLANDER (ISLE OF MAN) LIMITED AND THE FINANCIAL SUPERVISION COMMISION dated the 9th day of October 2008

AFFIDAVIT OF GABRIEL MOSS

I, **GABRIEL MOSS**, of 3-4 South Square, Gray's Inn, London WC1R 5HP **DO SWEAR AND MAKE OATH AND SAY** as follows:

1. I am a barrister admitted to the Bar of England and Wales and a member and bencher of Lincoln's Inn. I am a Queen's Counsel. I also sit as a Deputy Judge of the Chancery Division of the High Court of England and Wales.

2. The statements contained in this Affidavit are within my own knowledge and are true.

3. There is now produced and shown to me marked "GM1" an exhibit to which I refer in this affidavit.

4. I make this Affidavit at the request of the Isle of Man Treasury and in order to assist the High Court of Justice of the Isle of Man Chancery Division in its determination of the above-named proceedings.

5. An extensive part of my practice relates to insolvency and restructuring. In this context, I have advised extensively and appeared as an advocate in relation to numerous schemes of arrangement under the English Companies Acts and equivalent foreign legislation. I am also an author of numerous insolvency related textbooks and articles including Lightman & Moss, *The Law of Administrators and Receivers of Companies*; Totty & Moss, *Insolvency*; Moss, Fletcher & Isaacs, *The EC Regulation on Insolvency Proceedings*; and Moss & Wessels, *EU Banking and Insurance Insolvency*.

6. A copy of my curriculum vitae is at Exhibit "GM1".

7. I have been provided with and have read materials provided including the first, second and third affidavits of David C. Lovett, the first and second affidavits of John Wright, the first, second and third affidavits of Michael Simpson, the first and second affidavits of Allan Robert Bell and the exhibits to those affidavits. I have also read a transcript of the judgment of Deputy Deemster Corlett of 29 January 2009 **("the Judgment")**.

The Proposed Scheme of Arrangement

8. I understand that Kaupthing Singer & Friedlander (Isle of Man) Limited **("the Company")** is a company incorporated under the law of the Isle of Man and is the subject of a winding up petition presented jointly by the Company and by The Financial Supervision Commission.

9. I understand that on 9 October 2008 the High Court appointed Michael Simpson as Joint Liquidator Provisionally of the Company. I understand that on 20 November 2008 Peter Spratt was also appointed as Joint Liquidator

Provisionally. I further understand that the winding-up petition has subsequently been adjourned and that no winding-up order has yet been made.

10. I am informed that the Company carried on business as a "*deposit taker*" within the meaning of the Financial Services Act 2008, Compensation of Depositors Regulations 2008 **("the 2008 Regulations")** and is a "*participant*" within the meaning of Regulation 7 of the 2008 Regulations. The 2008 Regulations establish a Depositors' Compensation Scheme **("the DCS")**.

11. Under the DCS, upon a "*default*" arising in relation to the Company, a fund would be created from certain sources and be used, *inter alia*, for paying compensation to depositors. A "*default*" would arise in relation to the Company for these purposes upon, *inter alia*, the making of a winding up order in relation to the Company.

12. I understand that it is proposed that, as an alternative to a winding-up order being made at the present stage and the triggering of a default for the purposes of the DCS, the Company would enter into a scheme of arrangement with its creditors pursuant to Section 152 of the Companies Act 1931 **("the Scheme")**. I understand that the intention of the Scheme would be to replicate the financial treatment which creditors would receive in a liquidation and under the DCS but provide for payments to made in a more efficient and timely manner whilst not prejudicing any claims which the Company may have against third parties.

13. In these circumstances, I have been asked to comment generally on the law and practice relating to schemes of arrangement under the English Companies Acts in so far it may be relevant to the proposed Scheme and to comment in particular on certain issues identified in the Judgment, namely:

    (1) how claims against third parties (for example, regulators, directors or other governments) might be dealt with;

(2) whether there should be different meetings for different classes of creditors;

(3) the mechanics of holding the meetings of creditors to consider and, if thought fit, approve the Scheme;

(4) how the Scheme would be recognised and given effect to in other jurisdictions.

Schemes of Arrangement

14. Section 152 of the Companies Act (1931) **("the 1931 Act")** enables a compromise or arrangement to have binding effect between a company and its creditors, or any of class them, where the compromise or arrangement is:

(1) approved by a majority in number representing three-fourths value of the creditors or class of creditors (as the case may) present and voting (either in person or by proxy) at the relevant meeting; and

(2) sanctioned by the Court.

15. Section 152 is in essentially the same terms as the equivalent provisions of the English Companies Acts. The most recent version of these provisions is Section 899 of the Companies Act 2006.

Compromise or arrangement

16. The concepts of a "*compromise*" and an "*arrangement*" are wide ones. The concept of an "*arrangement*", in particular, is very wide and the authorities show that it may include anything which involves some elements of give and take on the part of the company and the relevant creditors respectively.

(1) Professor Goode (*Principles of Corporate Insolvency*, 3rd ed.) comments as follows (p.26):

" 'Arrangement' (which is synonymous with 'scheme of arrangement') has a very wide meaning embracing such diverse schemes as conversion of debt into equity, subordination of secured or unsecured debt, conversion of secured into unsecured claims and vice versa, increase or reduction of share capital and other forms of reconstruction and amalgamation. Though typically it involves agreement with a number of creditors, it has been held that even agreement with a single creditor may constitute an arrangement. But both 'compromise' and 'arrangement' imply an element of give and take and do not cover a situation in which rights are surrendered or extinguished with no countervailing benefit."

(2) In *Re T&N plc (No 3)* [2007] 1 All ER 851 (para. 50) David Richards J, referring to the previous authorities, stated:

"A scheme of arrangement which did no more than expropriate the interest of a member or creditor would not be a compromise or arrangement within s 425 of the 1985 Act: Re NFU Development Trust Ltd [1972] 1 WLR 1548. Brightman J observed that a compromise implies some element of accommodation on each side and that an arrangement implies some element of give and take. Total surrender or confiscation was not within either of them. In commenting on this decision in Re Savoy Hotel Ltd Nourse J said at 359, that the word 'arrangement' in s 425 of the 1985 Act and its predecessors is one of very wide import, a proposition which was by no means diminished by Brightman J's judgment:

'All that that case shows is that there must be some element of give and take. Beyond that it is neither necessary nor desirable to attempt a definition of "arrangement".'

As members' schemes such as that in Re Savoy Hotel Ltd show, the give and take need not be between the members and the company, but may be between the members and a third party purchaser, with the company's only function being to register the transfer of shares and thereby terminate the existing members' status as members."

17. In my view, what is proposed in the present case, as described in Mr Lovett's second and third affidavits, would fall within the concept of an "*arrangement*" in Section 152.

Schemes of arrangement in England

18. In recent times, schemes of arrangement have been used extensively in England both in the contexts of corporate restructurings (for example, in order to facilitate a "*debt for equity*" swap[1]: see for example Marconi, Telewest, MyTravel, Drax) and in order to wind up the affairs of insurance companies, where the nature of the business means that a scheme of arrangement often offers a more flexible and efficient way of managing a run-off of the business of and/or winding up the affairs of the company than a liquidation. In my view, there is some analogy between the present case and the situation where the business of an insolvent insurer is sought to be run off and/or wound up. In both cases, a scheme would be proposed as offering a more flexible and efficient way of running off the business and/or winding up the company.

Development of procedure for insolvent insurers

19. The difficulties of running off the business of and winding up an insolvent insurance company under the normal liquidation rules, and in particular the very long time required to conclude an insolvent liquidation and the costs thereof, led insolvency practitioners in England during the 1990s to develop a new procedure, as an alternative to liquidation, based on schemes of arrangement under (what was then) Section 425 of the Companies Act 1985 and (what is now) Section 899 of the Companies Act 2006.

20. As with Section 152 of the 1931 Act, Section 425 provided for a company to enter into a compromise or arrangement with its creditors; such a compromise or arrangement was then binding on the creditors, on the company and on any liquidator of the company provided that it was approved by at least three-quarters in value of each class of creditors and sanctioned by the court.

21. However, a problem with Section 425 as a free-standing procedure in many cases was that it did not provide for a stay on claims by creditors against the

[1] Separately, schemes of arrangement are often used in the context of mergers and acquisitions in order to implement a take-over by one company of another.

company or its assets whilst the scheme was being prepared and approved. Therefore it remained open to any creditor to commence or continue proceedings against the company prior to the sanction of the court to the scheme being obtained (or following such sanction if the creditor was not subject to any stay imposed by the scheme itself). Furthermore, there was no mechanism whereby an independent officer of the Court could be appointed to manage the company's affairs pending the approval of the scheme.

22. Limited protection for the assets from claims of creditors could be obtained by the company or a creditor presenting a petition for the winding up of the company, at which point the English court has a discretionary power to stay proceedings being brought against the company[2]. However, the appointment of a provisional liquidator offered significant advantages over this approach. In particular the appointment of a provisional liquidator:

    (1) means that an independent officer of the Court has taken control of the assets and affairs of the company and can assist with and supervise the realisation of assets and run-off of the company's business and the preparation of the scheme of arrangement, ensuring that both are conducted in the interests of creditors;

    (2) creates an ability to exercise powers under the insolvency legislation (for example, in relation to the use of investigatory powers) in the interests of the estate.

    (3) in England also results in a mandatory stay of proceedings being brought against the company[3];

Thus a practice was developed whereby the company would itself present a winding-up petition and provisional liquidators would be appointed by the

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[2] Section 126 IA 1986. It is not an abuse of process to present a petition to protect a proposed scheme even though no winding up order is intended to be sought: *Re Esal Commodities Ltd* [1985] BCLC 450.

[3] Section 130(2) IA 1986.

court with extended powers to manage the business and assets of the company, including a power to formulate and propose a scheme of arrangement. The petition was then adjourned from time to time (usually every 6 months upon a report being given to the Court as to progress of the provisional liquidation) pending the implementation of a scheme of arrangement[4].

23. Once the scheme has been approved by the creditors and sanctioned by the court, the petition might then be dismissed and the scheme would usually operate independently. Whether, and at what time, the petition is dismissed would depend, *inter alia*, on the extent to which it was necessary for the provisional liquidators to remain in office and for the statutory stay on creditors' remedies to remain in place (see further paragraph 31 below).

24. The first application of this combined procedure of provisional liquidation and schemes of arrangement occurred in 1992 in relation to the "KELM" (later KWELM) insurance companies[5], in relation to which I acted as leading counsel for the provisional liquidators/scheme supervisors. In that case the directors of the companies had presented winding-up petitions against the companies in order to obtain a (discretionary) stay on proceedings against the company whilst a scheme was being agreed and implemented. However, certain creditors were unhappy with the management of the run-off of the companies' businesses and the preparation of the scheme being left with the directors and made a successful application for the appointment of provisional liquidators over the companies to supervise the run-off and the preparation of the scheme. The provisional liquidator was given wide powers, akin to those of an administrator, to manage the companies and to take over the preparation and implementation of the scheme. Subsequently a scheme of arrangement was in fact approved and implemented.

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[4] Repeated adjournments are usually necessary due to the time it usually takes to prepare and implement a scheme of arrangement.

[5] The "KELM" companies were Kingscroft Insurance Co Ltd, El Paso Insurance Co Ltd, Lime Street Insurance Co Ltd and Mutual Reinsurance Co Ltd. The "W" was Walbrook Insurance Co Ltd.

25. The precedent set by the KWELM case was followed in many of the subsequent insurance insolvencies and the procedure of combining a scheme of arrangement with provisional liquidation has become accepted as an effective and efficient *de facto* insolvency procedure for dealing with insolvent insurance companies. The procedure was approved by the courts; for example in *Re English and American Insurance* [1994] 1 BCLC 649. Mr Justice Harman stated that the procedure was:

> "all part of the developing practice of the court of using a petition by the company for its own winding up as the basis for the appointment of provisional liquidators. That practice has been developed to mitigate the difficulties caused by the fact that administration procedures are not available in respect of insurance companies and is a practice which several of the Chancery judges have dealt with and approved of. It seems to me a useful practice and I do not wish in any way to cast any doubt or discredit upon it. It is a good system, particularly in cases such as this where there is a hope that in the future there will be a scheme of arrangement under Section 425 of the Companies Act 1985."

26. In *Smith v UIC* [2001] BCC 11 at p.20-21, His Honour Judge Dean, sitting as a deputy High Court Judge, stated:

> "A description of the traditional functions of provisional liquidators appears in Palmer's Company Law (Sweet & Maxwell) at para. 15-240. It appears, however, from the evidence in this case in the form of the statement of Mr Jacob, who is experienced in these matters, that the appointment of a provisional liquidator can be used for far wider purposes. He explains that in the case particularly of insurance companies the procedure of appointing a provisional liquidator is frequently, if not inevitably, made not for the purpose of safeguarding rival priorities or protecting assets in a pending full blown liquidation, but in order to enable a form of administration of the company with a view to resolving the financial difficulties, not necessarily by a winding up but by a scheme of arrangement under s. 425 of the Companies Act 1985. The reason that this procedure is adopted is that the provisions for administration contained in Pt. II of the Insolvency Act 1986 in terms [page 21] do not apply to insurance companies. That is s. 8(4) of the 1986 Act. Nonetheless, when one is dealing with an insurance company, particularly a company which has international interests, and even more so with a reinsurance company whose affairs can be complex and technical in a high degree, the ordinary processes

of liquidation do not necessarily produce the most satisfactory results both for the company itself and for claiming creditors.

This development is discussed in The Law of Receivers and Companies (1994, Sweet & Maxwell), by Sir Gavin Lightman and Mr Gabriel Moss QC among others. At pp. 19–20 there is discussion of the use of the procedure of appointing a provisional liquidator to achieve something other than mere interim protection in the course of a normal winding up.

This is further elaborated by an article by Mr Moss and another author in the publication Insolvency Intelligence, vol. 6, p. 1, January 1993. In the context of the insolvent insurance company or the insolvent reinsurance company, there are many advantages in this course which gives a greater flexibility in the disposal of the assets and ultimately with a view, as I say, to reaching effective agreement with the creditors without the more formal consequences that might be involved in a full liquidation under a court order.

I raised the question whether this might not be a way of avoiding the prohibition under s. 8(4) of the Insolvency Act, but there is no suggestion that is so. Indeed, it is apparent from the form of the court order in this case that the court must have had very much in mind these sort of possibilities."

27. The combination of provisional liquidation with a scheme of arrangement proved to be a practical and efficient way of dealing with insolvent insurance companies without having to go through the delay and expense of a formal liquidation. It was so successful, that liquidation of insolvent insurers became relatively rare and a number of solvent run-off schemes were modelled on the insolvent scheme to bring finality to run-offs even where there was no immediate likelihood of insolvency.

28. To some extent the use of this procedure for insolvent English insurance companies has now fallen into abeyance in England, following changes to the insolvency legislation which mean that the administration procedure under Part II of the Insolvency Act 1986 is now available to insurers. Accordingly, an insolvent insurer would now go into administration to obtain the same advantages as provisional liquidation and a scheme of arrangement may well be promulgated by the administrators from within administration. However,

the principle remains the same, namely, that a scheme is promoted from within the context of a procedure which provides for a stay on creditor action and the appointment of an independent officer of the Court who has wide duties and powers which he can exercise in the interests of creditors.

Claims against third parties

29. Claims of the Company and investigative powers in relation to potential claims in relation to third parties appear to fall into three categories:

    (1) Those claims which are vested in the Company and which the Company by its authorised agent, such as a provisional liquidator or scheme supervisor may bring in its own capacity: for example, claims for breach of duty, breach of contract and so on.

    (2) Those powers vested in the Court which are only exercisable by the Court whilst an office-holder is in office. For example, the power of the Court under Section 206 of the 1931 Act to summon before the Court any person whom the court deems capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the Company for examination on oath.

    (3) Those claims which are only capable of being brought in the event that a winding-up order is made. The principal examples would appear to be the setting aside of fraudulent preferences under Section 250 of the 1931 Act or a claim for fraudulent trading against directors under Section 259 of the 1931 Act.

30. So far as the first category is concerned, the Company would be able to bring such claims notwithstanding the sanction of the Scheme and even if the winding-up petition was dismissed and the Joint Liquidators Provisional left office. If necessary or desirable, the Scheme could make provision as to who

was to bring such claims, how they were to be funded and how any proceeds were to be dealt with (for example, to be held on trust for scheme creditors).

31. So far as the second category is concerned, these powers would continue to be exercisable so long as the Joint Liquidators Provisional remained in office. If the winding-up petition was subsequently dismissed and the Joint Liquidators Provisional vacated office then the Court could no longer exercise this power[6]. However, any such difficulties would be dealt with by the winding-up petition remaining in place and the Joint Liquidators Provisional remaining in office, concurrently with the Scheme, until all necessary investigations which would or might require the use of these powers had been completed. This approach has been used in a number of insurance company schemes of arrangement without difficulty.

32. So far as the third category is concerned, these claims would only be available (to liquidators) in the event that a winding-up order was made. Thus, if investigations undertaken by the Joint Liquidators Provisional established a reasonable prospect of an action in respect of a fraudulent preference or for fraudulent trading under the 1931 Act, then it might be necessary for a winding up order to be made in the future. In that case, the Liquidators provisional would ordinarily be appointed as liquidators. These type of claims are unusual claims in the context of a regulated financial institution. Bank of Credit and Commerce International (BCCI) was a notable exception where fraud claims arose, but that was a case of a regulator's petition based on a massive and systematic fraud within a fundamentally corrupt organisation.

33. In paragraphs 11 and 12 of his affidavit of 28 January 2009 Mr Wright refers to the position of Kaupthing hf which I understand is the shareholder in the Company and which I understand issued an "*undertaking*" pursuant to which Kaupthing hf "*guarantees to discharge*" the liabilities of the Company in so far as the Company is unable to discharge them itself. As noted above, if the

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6 See *Re Kingscroft Insurance Co Ltd* [1994] 1 BCLC 80 (one of the KWELM companies referred to above).

Scheme is sanctioned by the Court, then it is intended that the Joint Liquidators Provisional will remain in office at least until such time as all necessary investigations would or might require the use of their powers has been completed. Even if those investigations are completed and it is decided that no winding up order is necessary, the winding down of the Company's affairs will be conducted by the Joint Liquidators Provisional in their capacity as scheme supervisors. Accordingly, the Company will remain under the control of the Joint Liquidators Provisional or the scheme supervisors and control will not revert to the Company's directors or shareholders. Further, I understand that any liability of Kaupthing hf as guarantor will be unaffected by the proposed Scheme.

Classes

34. The established test under English law as to whether more than one meeting of creditors is necessary to consider a proposed scheme is whether the **rights** of the creditors are so dissimilar as to make it impossible for them to consult together with a view to their common interest (*Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 (CA); *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480 (CA), para. 26). In the *Sovereign* case, Bowen LJ held that the word "*class*" in the legislation:

> "must be confined to those persons whose rights are not do dissimilar as to make it impossible for them to consult together with a view to their common interest."

35. In answering this question, it is necessary to consider the rights which the creditors have against the Company and the rights which the creditors will receive under the proposed scheme. As the Court of Appeal stated in *Re Hawk* (para. 30):

> "In each case [the] answer to the questions will depend upon analysis (i) of the rights which are to be released or varied under the scheme and (ii) of the new rights (if any) which the scheme gives, by way of compromise or arrangement, to those whose rights are to be released or varied."

36. In *Re UDL Holdings Ltd* [2002] 1 HKC 172 Lord Millett set out the relevant principles as follows (184-185):

> "(2) Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.
>
> (3) The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.
>
> (4) The question is whether the rights which are to be released or varied under the scheme or the new rights which the scheme gives in their place are so different that the scheme must be treated as a compromise or arrangement with more than one class."

37. Where a scheme is proposed as an alternative to a liquidation, the correct approach is to consider the rights which are to be released or varied under the scheme as the rights which creditors would have in the liquidation (*Re Hawk*, para. 42). Thus, as the *Hawk* case established, since actual and contingent creditors of a company have the same rights and those rights are treated in the same way in a liquidation (save as to mode of valuation), then they can form part of the same class for the purpose of voting on a scheme proposed as an alternative to liquidation.

38. In the present case, the Scheme is proposed as an alternative to a liquidation of the Company. If the Company is placed into liquidation, the DCS would be triggered. Unsecured and non-preferential creditors would be treated the same way under the liquidation rules (see Sections 247 and 248 of the 1931 Act). However, certain of these creditors would receive additional rights to compensation under the DCS. Accordingly, in terms of rights on a liquidation, the unsecured, non-preferential creditors fall into two groups:

(1) those creditors who have the ordinary rights on a liquidation;

(2) those creditors who also have a right to compensation under the DCS.

39. The right to compensation under the DCS is not a right *against the Company* such as to be taken into account for the purpose of formulating classes. However, even if the two groups have the same rights *against the Company*, they get different rights under the Scheme, and so in terms of the Court of Appeal's approach in *Hawk*, they constitute different classes of creditors in any event if their rights are so different they cannot consult together in their common interests.

40. In relation to the proposed Scheme, I understand that:

(1) Creditors would receive a right to 3 dividend payments on scheduled dates **("the Scheduled Dividends")** and to such further distributions as became available from asset realisations **("the Further Dividends")**;

(2) Creditors who would be entitled to compensation from the DCS on a liquidation of the Company will receive supplemental payments from the Treasury equivalent to those rights **("the Top-Up Payments")**.

41. In terms of rights under the Scheme, the creditors therefore clearly fall into two groups: those with rights to the Scheduled and Further Dividends alone, and those also with rights to the Top-Up Payments. The remaining question is whether the rights are so different that the two groups cannot consult together in their common interest. This is a question of judgment at the end of the day for the Court, but in my view, the safer course is for creditors to form two classes for the purposes of meetings convened to consider and vote on the Scheme in order to avoid the risk of the Court refusing to sanction the scheme on the grounds that the classes are not properly constituted.

42. In relation to depositors who would be entitled to compensation from the DCS, there is a distinction between individuals who are entitled to a maximum amount of compensation of £50,000 and other persons (including, for example, companies) who are entitled to a maximum amount of compensation of £20,000. However, it does not follow that such depositors are to be placed into separate classes for voting purposes. In my view, the rights of such depositors are not so dissimilar that they cannot consult together with a view to their common interest.

43. To the extent that there are any preferential creditors who are subject to the Scheme, then they would need to form a further class. Preferential creditors are however normally excluded from schemes and schemes can if necessary provide for them to receive priority payments out of scheme assets.

Role of the Court

44. Under Section 152 of the 1931 Act (as under the English legislation), the promulgation of a scheme essentially follows a three-stage process:

    (1) The initial order of the Court making an order that a meeting or meetings of creditors be convened to consider and, if thought fit, to approve the scheme;

    (2) The meeting or meetings of creditors;

    (3) The order of the Court sanctioning the scheme.

45. Under the present English procedure, the principal issue for the Court at the convening stage is to be satisfied that the Company's proposals for the summoning of meetings of creditors to consider the Scheme are appropriate. In particular, the Court is required to consider whether more than one meeting of creditors is required and, if so, what is the appropriate composition of the meetings. This is reflected in the terms of a Practice Statement issued by the

High Court in 2002: *Practice Statement (Companies: Schemes of Arrangement)* [2002] 1 WLR 1345.

46. The Practice Statement is aimed at avoiding the problems which occurred in *Re Hawk* [2001] 2 BCLC 480 by encouraging any issues relating to the constitution of the meetings of creditors summoned in order to consider a proposed scheme to be determined at the stage when the Court directs the summoning of those meetings. In accordance with the Practice Statement, it is now usual to notify creditors of the proposals for convening meetings prior to the convening hearing. This is done by way of letter and typically 7 to 14 days notice may be given.

47. However, the position may be different in the Isle of Man. Prior to the 2002 Practice Statement, the position in England was governed by a Practice Notice issued by Eve J and reported at [1934] WN 142. In relation to court's consideration of the composition of meetings of creditors, the position under the Practice Notice was as described by Lord Millett in *Re UDL Holdings Ltd* (paras. 13-14) (a decision of the Court of Final Appeal of the Hong Kong SAR):

> "13. At the first stage the Court does not address the question whether it is necessary to order more than one meeting. The practice in England was established by a Practice Note issued by Eve J and reported in [1934] WN 142. This laid it down that it was the responsibility of the company which was putting forward the Scheme to decide whether to call more than one meeting and if so how the meetings should be constituted. If they were incorrectly constituted or objection was taken to the presence of any class of creditors the objection ought to be taken on the application for sanction and the company must take the risk of the application being dismissed.
>
> 14. It might be thought singularly unhelpful to leave the question whether the meetings were correctly convened to the third stage, by which time a wrong decision by the company at the outset will have led to a considerable waste of time and money. But in my opinion the practice is a sound one. The only alternative would be to require notice of the initial application to be made inter partes and for notice of the application together with a copy of the Scheme to be given to everyone potentially affected by it, with the risk of incurring the costs

of a contested hearing and possible appeals before it could be known whether the Scheme was likely to attract sufficient support in any event."

48. If practice in the Isle of Man follows the position in England prior to the 2002 Practice Statement, then it would not be necessary to inform creditors of the convening hearing (which would be an *ex parte* application by the company). However, creditors would be able to challenge the composition of classes at the sanction hearing and the Company would run this risk. Alternatively, the Court may consider it appropriate to adopt the post-2002 practice in England whereby creditors are notified by letter of the proposed scheme prior to the convening hearing so that any class issues can be dealt with at that stage.

Mechanics of Scheme meetings

49. In relation to the mechanics of holding meetings of creditors, the Court in England will give appropriate directions at the convening stage. Typically, the meeting(s) and proposed scheme are notified to creditors by:

    (1) Sending a copy of the scheme, explanatory statement and form of proxy to each creditor by first class of post of whose address the Company is aware;

    (2) Advertising the scheme and the meetings in appropriate publications and media having regard to the nature and geographical location of the creditor base.

50. In the present case, it could also be beneficial to use advertisement on relevant websites. It may also be appropriate to have a simplified summary of the scheme for private individuals.

51. Typically, about a month's notice of the scheme meetings will be given.

52. In relation to voting at scheme meetings, Section 152 provides that the scheme must be approved by a majority in number representing three-fourths in value

of the creditors or class of creditors present and voting either in person or by proxy at the meeting. This statutory test protects the interests of creditors by having regard both to the value of creditors' claims and to the number of creditors who constitute the relevant class.

Recognition

53. In practice, the issue of recognition turns on the question of whether a statutory stay imposed under Isle of Man law on action by creditors of the Company will be extended by means of judicial assistance from other courts so as to have effect in other jurisdictions where the Company has assets so as to protect those assets from creditor action and thus in effect require any such creditor, if he wishes to participate in a distribution of the Company's assets, to do so by making a claim in the Scheme.

54. I am able to advise on the position in relation to England. To the extent that it might be necessary to seek recognition in other jurisdictions where the Company has assets then it would be necessary to consider the position with a lawyer qualified in the law of that jurisdiction.

55. As a matter of Isle of Man law, assuming the Scheme has been sanctioned by the Court, then a statutory stay will arise pursuant to the terms of the Scheme itself and, to the extent that the winding-up petition remains in place, pursuant to the Court's power under Section 166 of the 1931 Act to stay proceedings against the Company.

56. In relation to recognition of the Scheme itself, there is Privy Council authority to suggest that the English Courts may recognise and grant relief in aid of the Scheme pursuant to common law principles of assistance (*Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508 (an appeal from the Isle of Man)). *Cambridge Gas* suggests that in such a case the English Courts may grant such relief in aid of a foreign proceeding based on insolvency as it could have

granted in the case of a domestic proceeding based on insolvency. This would include staying an action by a creditor against the Company in the English courts.

57. In addition, it might be possible to obtain relief in recognition of the Scheme under Section 426 of the Insolvency Act 1986, which provides for co-operation between courts exercising jurisdiction in relation to insolvency. The Isle of Man is a "*relevant country or territory*" for the purposes of the section (Section 426(11)(a)). The grant of relief would be dependent on persuading the English Court that Section 152 of the 1931 Act represented part of Manx "*insolvency law*" so that the English Court could apply this part of Manx law pursuant to the power in Section 426(5) to apply the insolvency law of the requesting state. There is some support for the view that the English Court may regard foreign law provisions relating to schemes of arrangement as forming part of that country's "*insolvency law*" when applied to insolvent companies (see *Re Business City Express* [1997] 2 BCLC 510). Although in *Hughes v Hannover Re* [1997] BCC 921(CA) a narrow view of the scope of "*insolvency law*" for the purposes of Section 426(10) was taken, the inclusion of the Irish scheme within the scope of Section 426(10) in *Re Business City Express* could be justified on the basis that a scheme can be regarded as being "*comparable*" to a company voluntary arrangement (CVA) under the Insolvency Act 1986, since CVAs were introduced to be a simplified form of scheme in insolvency cases.

58. In relation to the provisional liquidation of the Company, relief could also be granted by the English Courts:

    (1) Pursuant to Section 426, upon a request from the Isle of Man Court, the English Court could and should in any proper case grant relief in aid of the Isle of Man provisional liquidation by staying actions by creditors against the Company;

(2) Pursuant to the Cross-Border Insolvency Regulations 2006 (which enact the UNCITRAL Model Law on Cross-Border Insolvency **("the Model Law")** into English law), since the provisional liquidation would be a "*foreign proceeding*" within the meaning of Article 2(i) of the Model Law and the Joint Liquidators Provisional would be "*foreign representatives*" within the meaning of Article 2(j). The effect of recognition would be to give rise to a stay under English law (Article 20.1).

59. The relief referred to in paragraph 58 would be dependent on the provisional liquidation of the Company continuing. These would be further reasons why, in my view, it may be prudent in the present case for the winding-up petition to remain in place, and the Joint Provisional Liquidators in office during the Scheme, at least until all assets have been realised and all necessary investigations have been completed by the office-holders.

SWORN at London
12 SOUTH SQUARE,
GRAYS INN, LONDON

This 12th day of February 2009

Gabriel Moss

Before me:

A. H. TOKHEK

A Solicitor/Commissioner for Oaths

Serial No. 2008/94

IN THE HIGH COURT OF JUSTICE OF THE ISLE OF MAN
CHANCERY DIVISION

IN THE MATTER OF THE COMPANIES ACT 1931

AND IN THE MATTER OF KAUPTHING SINGER & FRIEDLANDER (ISLE OF MAN) LIMITED

AND IN THE MATTER OF THE JOINT PETITION OF KAUPTHING SINGER & FRIEDLANDER (ISLE OF MAN) LIMITED AND THE FINANCIAL SUPERVISION COMMISION dated the 9th day of October 2008

AFFIDAVIT OF GABRIEL MOSS
